economic trends

August 2013

Household spending fuels economic expansion

This edition of Trends is taken from the First Quarter Fiscal Update and Economic Statement, released on August 29th, 2013. The InFocus examines the impact of the southern Alberta flooding on economic activity in the province.

Alberta continues to power the Canadian economy, leading all provinces in real GDP and employment growth in each of the last two years. The economy is on track to grow at another solid, albeit slightly more moderate, pace in 2013.

Overall, real GDP is forecast to expand by 3.1% this year, slightly higher than the 2.9% forecast at *Budget 2013* (Chart 1). The upgrade mainly reflects increased economic activity as a result of reconstruction efforts following the flooding in southern Alberta (see InFocus).

Prior to the flooding, events in 2013 had largely unfolded as expected at *Budget 2013* with some exceptions. Employment growth has been stronger than expected. In-migration has also surprised to the upside, contributing to a jump in new housing activity. A healthy economy combined with relatively high wages has led to large and sustained inflows of international and interprovincial migrants. These factors have offset slightly weaker-than-expected exports.

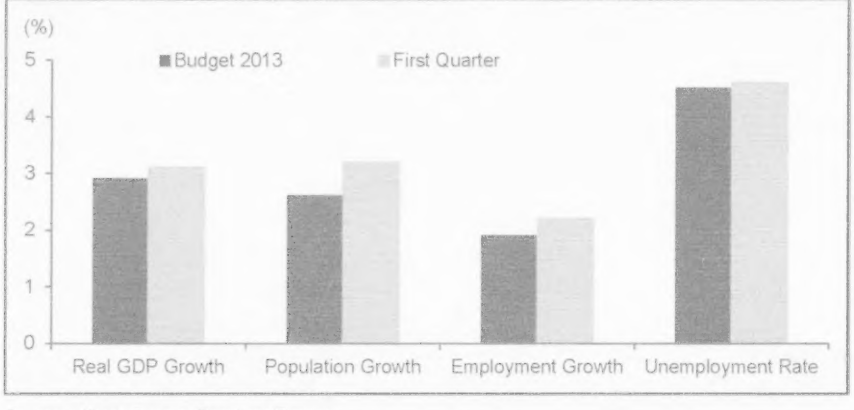
Recent developments in financial markets have generally been favourable to Alberta. In early July, the Canadian dollar fell to its lowest level in almost two years before rebounding slightly. Crude oil price differentials have also narrowed significantly, yielding a higher price to Alberta oil producers.

Key Indicators — All indicators seasonally adjusted unless otherwise indicated

Indicator	Latest Month	Value	Change year-over-year (y/y)
Employment (thousands)	July	2,217	+3.0%
Unemployment Rate	July	4.5%	-0.1p.p.
CPI Inflation	July	2.2%	+1.3 p.p.
Retail Sales	June	$6.1B	+7.7%
Housing Starts (annualized)	July	33,608	+1.2%
Rigs Drilling (unadjusted)	August	239	+7.0%
Manufacturing Shipments	June	$6.1B	+2.7%
Exports (unadjusted)	June	$7.7B	-0.5%

Source: Statistics Canada, CAODC, CMHC. p.p.= percentage points

Chart 1: 2013 Forecast for Alberta Economic Indicators



Source: Alberta Treasury Board and Finance

Alberta Household Sector

Population forecast revised higher as migration surges

Alberta's population is on pace to swell to over 4 million people by the end of the calendar year. Net in-migration has been trending higher since early 2011. In the first quarter of 2013, Alberta gained 27,100 people from other provinces and countries, the highest level on record. As a result, the population of Alberta is now expected to expand by 3.2% in 2013, up from 2.6% at *Budget 2013*.

The labour market remains healthy, with employment expanding 2.3% so far this year. This is down from 2012's average rate of job growth, but on pace to exceed the *Budget 2013* forecast. Employment is now expected to grow by 2.2% in 2013, up from the previous forecast of 1.9%.

Surging in-migration has increased the number of people looking for work, adding to the labour force. Over the second half of 2012 and early 2013 growth in the population far outpaced that of the labour force; more recently, labour force growth has moved more closely in line with population growth (Chart 2). Despite a stronger rate of labour force entry, Alberta has continued to create enough jobs to keep the unemployment rate low. In July, the unemployment rate

fell back to 4.5% after seeing some upward pressure in May and June. Jobs in flood related reconstruction should put additional pressure on already tight labour markets in some industries, such as construction. In 2013, the unemployment rate is expected to average 4.6%.

Edmonton propels housing starts

The influx of people to Alberta has given additional strength to the housing market. Over the first seven months of 2013 housing starts have averaged 36,500 (annualized), well ahead of the *Budget 2013* forecast of 32,600.

Edmonton has been a major driver of new home construction in Alberta, with housing starts up 31% year-to-date. This has more than offset a pullback in Calgary housing starts over the same period. Flood reconstruction will likely boost new home building in Calgary for the remainder of the year.

Reflecting strong year-to-date results and flood reconstruction expected in the second half, the forecast for 2013 housing starts has been upgraded to 37,000.

Motor vehicles drive retail spending

Consumer spending has shown persistent strength in Alberta. Through June, retail sales are up 6.5% over the first half of 2012, more than three times the national increase.

Automobile sales have been especially strong (Chart 3). New motor vehicle sales topped $1 billion for the first time ever in May, rising 10.4% over the same month last year. New motor vehicle sales will likely be bolstered in the second half as flood damaged vehicles are replaced.

In light of these developments, real consumer spending is expected to expand by 4.5%, compared with 3.7% in the *Budget 2013* forecast.

Inflation returns, earnings pick up

After an extended period of very weak price increases, consumer inflation has moved above 2% in each of the last three months, lifted by higher energy and accommodation costs.

Increased demand for goods and services for reconstruction is expected to put pressure on wages and prices. As a result, inflation in 2013 is now expected to be 2.0% in 2013, up from 1.8% at *Budget 2013*.

Average weekly earnings have also picked up and are now expected to expand by 3.8%, up from 3.5% forecast at *Budget 2013*. Strong population growth has added to Alberta's labour supply and prevented even stronger increases in wages. Reflecting higher growth in weekly earnings and employment, the forecast for primary household income growth has been revised up to 5.9%.

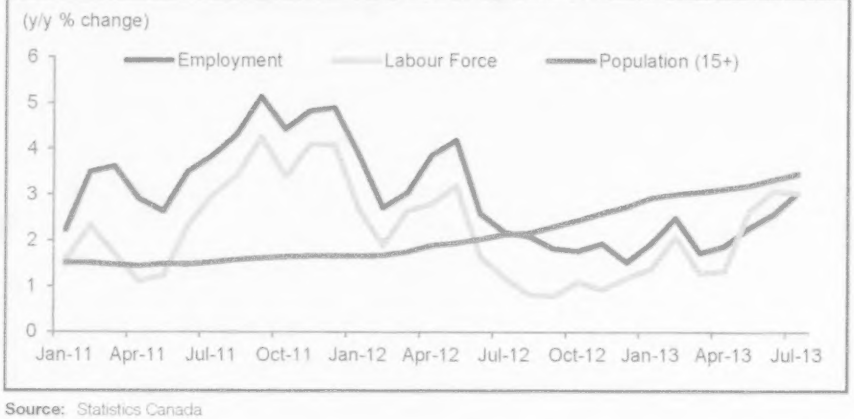
Alberta Business Sector

WTI nears parity with Brent

The benchmark North American oil price, West Texas Intermediate (WTI), has increased markedly in recent months (Chart 4), moving closer to the global benchmark price (Brent). The Brent - WTI differential narrowed from around $20 US/bbl in February to under $5 US/bbl in July and early August, reflecting an easing of transportation bottlenecks at Cushing, Oklahoma, including pipeline projects that have rerouted oil flows from Cushing to the Gulf Coast. The spread between WTI and the Alberta heavy oil benchmark, Western Canada Select (WCS), has also narrowed since early 2013 due to increased rail shipments and lower-than-expected bitumen production.

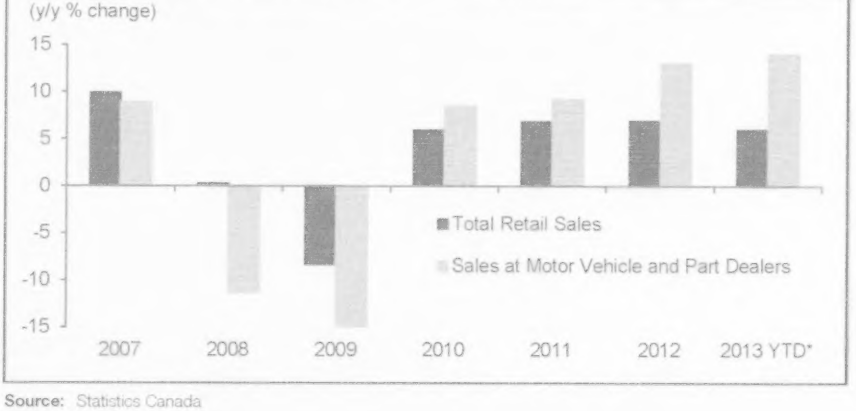
Based on recent developments, the forecasts for both WTI and WCS have been upgraded in FY 2013–14 to $US94.81/bbl and $CDN74.51/bbl respectively. The natural gas Alberta Reference Price forecast remains roughly in line with *Budget 2013* at CDN$3.14/GJ.

Chart 2: Growth in Alberta's Labour Market



Source: Statistics Canada

Chart 3: Alberta Retail Sales Growth



Source: Statistics Canada

Canadian dollar falls

For the first time in almost 2 years, the Canadian dollar fell below 95 USc/Cdn$ in early July as Federal Reserve officials speculated about tapering their quantitative easing (QE) program. It has since edged up slightly, but remains volatile. The exchange rate forecast for 2013–14 has been lowered to 98 USc/$Cdn.

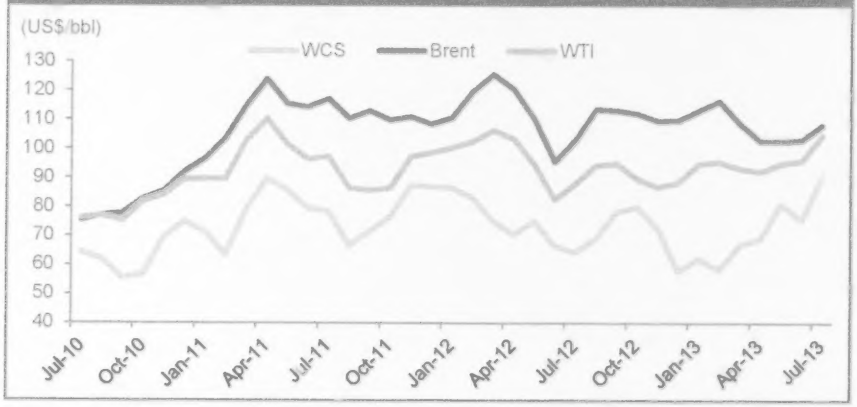
Corporate profits forecast holds steady

Higher-than-expected energy prices will provide a boost to corporate profits. However, the June flooding has substantially increased costs for many businesses, forced substantial write downs of various assets, and led to losses in the insurance industry. Higher wage growth will also weigh on profits. On balance, the forecast for growth in net corporate operating surplus is roughly in line with *Budget 2013* at 6.3% in 2013.

Investment growth expected to pick up in second half

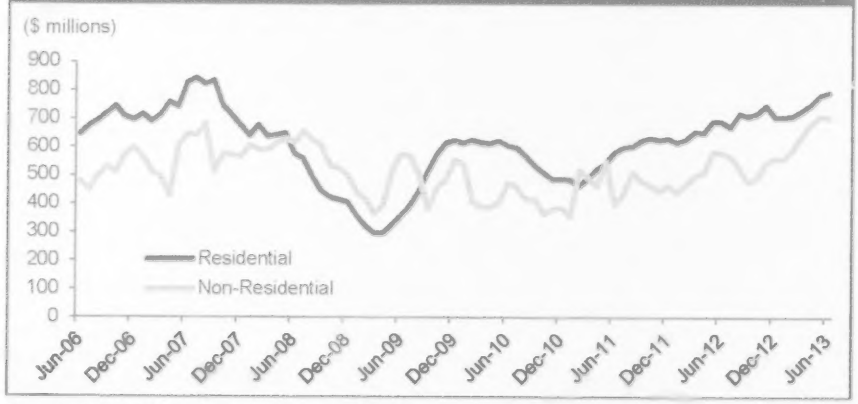
The rebound in energy prices has supported project economics. Drilling activity has shown signs of stabilizing following a sharp drop in the second half of 2012. Gains in bitumen drilling have helped offset declines in natural gas drilling.

Chart 4: Oil Prices



Source: Alberta Energy

Chart 5: Alberta Building Permits*



Source: Statistics Canada
* 4–month moving average

Overall investment in non-residential construction has been slow in the first half of 2013, up a modest 1.9%. This pace is expected to accelerate in the second half of 2013, reflecting the recent upward trend in non-residential building permits (Chart 5) and the need to repair or replace flood-damaged buildings.

Likewise, investment in machinery and equipment (M&E) appears to have stalled in the first half over the same time last year, as indicated by a dip in international M&E imports. The need for businesses to replace flood-damaged machinery and equipment should provide a boost to investment later this year.

Exports recovering from drop in second half of 2012

After a decline in late 2012, Alberta's international goods exports have moved higher. However, export growth in the first half of 2013 has been modest, up +2.1% over the same period last year. Temporary oil supply disruptions have weighed on exports so far this year. With strong energy prices and production coming back on stream, year-over-year export growth is expected to pick up in the second half of 2013.

External Risks

Given the unstable state of the global economy and Alberta's high level of trade exposure, Alberta's economic outlook is subject to a number of risks:

- There is limited access to alternate markets for Alberta's rising oil sands production. A lack of spare pipeline capacity makes the price of oil produced in Alberta highly vulnerable to transportation and refinery disruptions.
- A further slowdown of emerging market economies, particularly in China, would weigh on global demand and commodity prices. A re-escalation of troubles in the Euro zone, which remains mired in economic stagnation, would also hurt global economic growth.
- Stronger than expected US economic growth, for example due to a rapid improvement in the housing market, is a major upside risk to the forecast.
- Sustained upward momentum in oil prices could lead to higher than forecast investment and employment growth. In addition, a further drop in the Canadian dollar could support stronger exports.

Impact of the floods on Alberta economic activity

The flooding in southern Alberta in late June will have profound impacts on Alberta's affected communities for several years to come. Immediately after the floods, there were major disruptions to economic activity. Reconstruction efforts have begun to replace or repair damaged property. In terms of real GDP growth, the substantial expenditures on reconstruction are expected to more than offset temporary disruptions. The net effect is that the floods are estimated to add 0.2 percentage points to growth in 2013 and 0.4 percentage points in 2014 (Figure 1).

A positive impact on GDP does not imply the floods were "good for the Alberta economy." GDP represents the market value of all newly produced goods and services in a given time. It ignores the stock of capital and consumer goods that were previously accumulated. Damage to these stocks imposes real economic costs on people that are not reflected in GDP.

Immediate aftermath

In the two weeks following the flood, economic activity in much of southern Alberta was severely disrupted. The Cargill meat packing plant in High River, which processes about 40% of Canada's beef, was temporarily shutdown. A leak in an Enbridge pipeline caused by heavy rains precipitated precautionary shutdowns throughout much of the Enbridge pipeline system. This forced producers to curtail production, find temporary storage, or alternative transportation. Tourism was also reduced. The Calgary Stampede had the lowest attendance in over a decade and access to popular outdoor destinations in southern Alberta was hindered. Banff National Park attendance was down sharply in June.

The flood wreaked havoc on infrastructure. Both major mountain passes south of Jasper were shutdown to non-emergency traffic for several days, significantly reducing trade with BC and abroad. Several rural highways are still closed. The damages to infrastructure will take years to completely repair.

Reconstruction

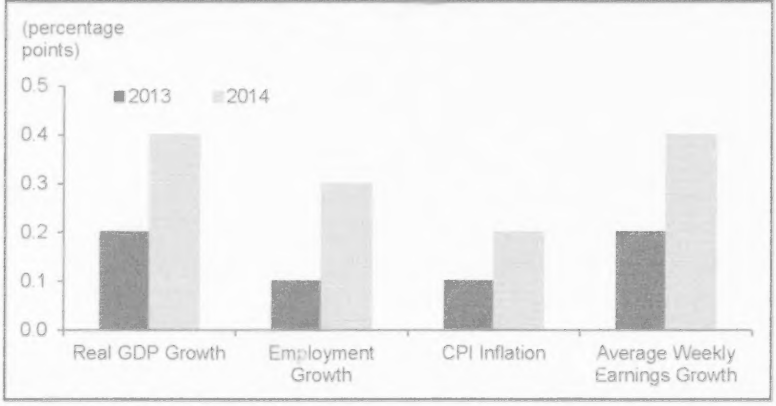
Homes were evacuated following the flood, immediately impacting about 100,000 people. Flood damage was incurred by over 14,500 dwellings. Repair and reconstruction of these dwellings will account for a significant portion of overall flood related costs.

Reconstruction costs will be shared by governments, insurance companies, and affected businesses and households. While most spending on immediate relief efforts, such as temporary housing and income support, will take place in 2013, capital expenditures will extend into 2014 and beyond. Expenditures will mostly take the form of residential and infrastructure investment, as well as retail purchases of building materials, household appliances and automobiles. The Alberta government has committed $1 billion for disaster recovery assistance with more funding expected to follow as damages are assessed. The federal government will also provide aid under the Disaster Financial Assistance Arrangement.

Many people will rely heavily on government assistance. Insurance against overland flooding is not included in basic home insurance, though automobiles are more broadly covered. The Insurance Bureau of Canada estimates that flooding in southern Alberta will generate one of the largest, if not the largest, insurable losses in Canadian history. The largest insurance payout to date was for the 1998 ice storms in Ontario and Quebec, estimated at $2 billion (in 2011 dollars).

Flood related spending will put pressure on prices and wages (Figure 1). With the labour market already fairly tight, there is little spare capacity in the economy. Increased reconstruction activity is expected to cause prices to rise and lead to some diversion of construction resources from elsewhere in the province. These constraints will limit the increase in real (price-adjusted) economic activity.

Chart 1: Estimated flood impact on Alberta indicators



Source: Alberta Treasury Board and Finance

Contact:

Kailer Mullet *780.427.7391*

Mark Parsons *780.427.8790*

infocus